

Message Text

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TO SECSTATE WASHDC 5854
INFO AMEMBASSY ABU DHABI
AMCONSUL ALEXANDRIA
AMEMBASSY DOHA
AMEMBASSY JIDDA
AMEMBASSY KUWAIT

C O N F I D E N T I A L SECTION 01 OF 02 CAIRO 05835

E.O. 11652: GDS
TAGS: EFIN, EINV, EAID, EG
SUBJ: FUTURE OF EGYPTIAN/GODE RELATIONS

1. SUMMARY. ALTHOUGH 1978 OPENED WITH GOE IN BEST BALANCE OF PAYMENTS POSITION IN TWO DECADES, SITUATION WAS CLEARLY RESULT OF MASSIVE GODE AND OTHER DONOR INFLOWS DURING 1977. AS GODE CAPITAL NOW ALMOST FULLY UTILIZED, BELIEVE IT INSTRUCTIVE TO RECAP HISTORY OF GOE-GODE RELATIONS AND EXAMINE POTENTIAL FOR FUTURE. CRUCIAL IMPORTANCE OF GODE FUNDING CONTINUES, DESPITE IMPROVED EGYPTIAN FX PICTURE, AND REPLENISHMENT INTENTIONS OF ORGANIZATION IS MAJOR QUESTION AT THIS TIME. END SUMMARY.

2. AS ADDRESSEES AWARE, GULF ARAB STATES ESTABLISHED GODE IN 1976 IN EFFORT TO FORMALIZE THEIR AID CONTRIBUTIONS TO EGYPT AND BREAK PREVIOUSLY EXISTING PATTERN OF REGULAR HIGH-LEVEL VISITS BY SADAT AND OTHER KEY FIGURES TO SOLICIT FURTHER ASSISTANCE IN EFFORT TO MEET EGYPT'S FINANCIAL
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REQUIREMENTS. SINCE 1973 WAR, PASSING THE HAT HAD BECOME STANDARD PRACTICE AS LIQUIDITY CRISES LOOMED CONTINUALLY ON EGYPT'S FINANCIAL HORIZON. SADAT'S PENINSULA TRIP IN FEBRUARY 1976 WAS LAST, BEST EXAMPLE OF THESE FORAYS. PRESIDENT SUCCEEDED THEN IN OBTAINING SOME \$750 MILLION FOR HIS EFFORTS--ONLY ENOUGH SUPPLEMENTARY FINANCING TO SUSTAIN EGYPTIAN IMPORT FLOWS THROUGH FIRST HALF OF THAT

YEAR. AWARENESS ON PART OF SAUDIS AND OTHER DONORS THAT SADAT OR OTHER HIGH-LEVEL GOE DIGNITARIES WOULD ALMOST CERTAINLY RETURN IN SHORT TIME LED TO CONVENING OF FINANCE MINISTERS CONFERENCE AT AL KHOBAR SHORTLY AFTER SADAT'S TRIP. AT THEIR SECOND SESSION AT RIYADH THEY AGREED TO CREATE A CONSORTIUM TO PROVIDE AID TO EGYPT.

3. GOE HAD HOPES FOR INITIAL IDEA AND BELIEVED IT WOULD ELIMINATE NECESSITY CONTINUALLY TO PRESS GULF STATES FOR GRANTS WHICH INEVITABLY TURNED OUT TO BE "PALTRY SUMS", IN EGYPTIAN VIEW, GIVEN ITS HEAVY FINANCIAL REQUIREMENTS. SADAT HAD ESTIMATED GULF CONTRIBUTION TO 1976-80 FIVE YEAR PLAN'S \$30 BILLION PROGRAM SHOULD BE \$6 BILLION. GOE MINFIN IN LATER DISCUSSIONS WITH CODE ORGANIZERS PUSHED FOR INITIAL CAPITALIZATION LEVEL OF \$10 - \$12 BILLION TO BE DRAWN DOWN OVER FIVE-YEAR PERIOD. DONOR DECISION TO HOLD CAPITAL TO \$2 BILLION FOR FIRST FIVE YEAR PERIOD WAS MET WITH DISAPPOINTMENT BY EGYPTIANS, WHO SAW THIS AS ATTEMPT TO KEEP THEM ON SHORT LEASH. HOWEVER, SAUDIS AND KUWAITIS, IN PARTICULAR, VIEWED ACTION AS NECESSARY TO CURB WHAT THEY PERCEIVED AS EGYPTIAN TENDENCY TO FISCAL IRRESPONSIBILITY AND BECAUSE OF THEIR FEAR THAT CASH ASSISTANCE WOULD BE REQUIRED INDEFINITELY.

4. IMPLEMENTATION PROBLEMS BETWEEN APRIL AND DECEMBER PREVENTED CODE FROM ACTING TO FORESTALL MAJOR LIQUIDITY
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CRISIS AT END OF 1976. AS EGYPTIANS DISCUSSED WITH DONORS MEMBERSHIP OF BOARD, CAPITALIZATION LEVEL, ETC., GOE SHORT-TERM ARREARS CLIMBED TO \$800 MILLION. CODE ONLY MANAGED TO EXTEND DIRECT LOAN OF \$250 MILLION AND INITIATE DISCUSSIONS FOR CODE-GUARANTEED LOAN OF SAME AMOUNT DURING FIRST NINE MONTHS OF OPERATION. SEEKING FINANCIAL SUPPORT FROM IMF, GOE MINISTERIAL ECONOMIC GROUP ANNOUNCED "AUSTERITY BUDGET" IN EARLY JANUARY 1977 AND WIDESPREAD RIOTING IN PROTEST FOLLOWED. JANUARY EVENTS PROVIDED CATALYST THAT BROUGHT ABOUT DECISIVE CODE ACTION IN EARLY PART OF LAST YEAR. BEFORE PARIS CONSULTATIVE GROUP MEETING IN MAY, CODE MEMBERS TOOK STEPS TO MAKE AN ADDITIONAL \$1,475 MILLION DIRECT LOAN AVAILABLE DURING 1977. CODE-GUARANTEED, CHASE-SYNDICATED LOAN FOR \$250 MILLION WAS AT LAST PUT TOGETHER. OTHER DONORS INCLUDING USG, IMF, IBRD, EEC AND JAPAN ALSO MADE SPECIAL PROVISIONS TO ASSIST EGYPT.

5. EGYPTIANS ON MOST COUNTS SEE CODE CONTRIBUTION AS THEIR JUST DUE. LOCAL PRESS HAS RECENTLY HERALDED ADMINISTRATION AND FORESIGHT SHOWN BY DEPPRIMIN KAISSOUNI AND ECONOMIC GROUP IN IMPROVING GOE'S BALANCE OF PAYMENTS PICTURE. FACT

THAT KAISSOUNI COULD NOT HAVE MANAGED IT WITHOUT ARAB CASH IS NORMALLY MINIMIZED. YET AMOUNT REQUIRED IN 1977 ALONE POINTS UP ARAB DONORS' HIGHLY SIGNIFICANT ROLE, AND PRESENT PROJECTIONS REFLECT CONTINUING GOE NEED FOR BALANCE OF PAYMENT FUNDING IN FORSEEABLE FUTURE TO SUSTAIN CURRENT IMPROVEMENTS. AS RESULT, QUESTION OF GOE REPLENISHMENT HIGHLY RELEVANT AND IMPORTANT IN EGYPT'S ECONOMIC PICTURE.

6. EVEN CURSORY STUDY OF GOE PROSPECTS FOR 1978 SUGGESTS IMPROVEMENTS ARE ESSENTIALLY SHORT-TERM PHENOMENON. NONE-THELESS, AS 1977 WAS YEAR OF EXCEPTIONALLY HEAVY FINANCIAL REQUIREMENTS RELATING TO ARREARS AND REDUCTION IN SHORT-TERM DEBT, 1978 IS PERHAPS EQUALLY UNUSUAL PERIOD. GIVEN

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SIZE OF CASH CONTRIBUTIONS TO OFFSET 1977 BURDEN, GOE ENDED YEAR WITH EXCESS FUNDS AND PROBABLY SUBSTANTIAL INCREASE IN INVENTORIES. AVAILABLE FX RESOURCES, CAREFULLY MANAGED, COULD SEE THEM THROUGH ENTIRE YEAR WITH SOME USE OF BANKING FACILITIES IN LATTER HALF. DESPITE THIS, EGYPT'S GROWING AND CRITICAL IMPORT REQUIREMENTS DEMAND \$4 - \$6 BILLION IN FOREIGN EXCHANGE ANNUALLY. EGYPTIAN EXPORTS ARE NOT EXPANDING RAPIDLY ENOUGH TO OFFSET THIS, NOR CAN STRENGTHENING SERVICES ACCOUNT--TOURISM, SUEZ CANAL TOLLS, AND EXPATRIATE TRANSFERS--BE EXPECTED TO SHOULDER ENTIRE BURDEN. PLANNED MAJOR PROJECTS THAT MIGHT GENERATE MORE EXPORT REVENUES ARE FOR MOST PART STILL YEARS AWAY FROM

COMPLETION. PETROLEUM PROSPECTS ARE GOOD, BUT EXPANDED EXPLOITATION WILL REQUIRE BOTH TIME AND MORE INFRASTRUCTURE INVESTMENTS THAN PRESENTLY ENVISIONED.

7. THUS, DESPITE MORE CONFIDENT VOICE OF GOE IN INTERNATIONAL FINANCIAL FORUM, REALITY IS THAT EGYPT REMAINS HEAVILY DEPENDENT ON CONTINUED LARGE INFLOWS OF ASSISTANCE FROM DONOR COMMUNITY, MOST NOTABLY GULF ARABS. CONFIDENTIAL

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GIVEN THIS FACT, MUCH CLOSER COORDINATION BETWEEN GOE AND GODE WOULD SEEM IN EGYPT'S BEST INTEREST. WE SEE LITTLE EVIDENCE THAT THIS IS TAKING PLACE, ALTHOUGH GOE EXPECTS TO BEGIN TALKS ON 1978 REPLENISHMENT WITH GODE IN NEAR FUTURE. (DEPRIMIN KAISSOUNI TOLD AMBASSADOR FEBRUARY 21 THAT NEGOTIATIONS WILL START "SOON;" HE HAS BEEN IN TOUCH WITH SAG MINFIN ABA AL KHAYL TO BEGIN PROCESS, BUT NO DATE HAS BEEN SET AS YET. KAISSOUNI EXPRESSED CONFIDENCE THAT NECESSARY LEVEL OF SUPPORT, IN FORM OF COMMODITY IMPORT FINANCING WITH SOME CAPITAL PROJECT FUNDING, WILL BE FORTHCOMING. HE NOTED ALSO NEED FOR CASH AID --IN UNSPECIFIED AMOUNT-- FROM GODE. WITH THIS EXPECTED FUNDING, FINANCING FROM OTHER DONORS AND ITS OWN FX EARNINGS, GOE ANTICIPATES BEING ABLE TO MEET ITS IMPORT REQUIREMENTS THROUGH END OF 1978. KAISSOUNI PAINTED COMPARATIVELY SANGUINE PICTURE OF EXTERNAL EGYPTIAN ECONOMY THIS YEAR.) 8. IN RECENT WEEKS, EMBASSY HAS HEARD VARYING ESTIMATES OF GODE REPLENISHMENT FIGURE RANGING FROM \$500 TO \$2,000 MILLION. CERTAIN GOE SOURCES ARE MOST UPBEAT. WE HEAR IMF, ON OTHER HAND, BELIEVES ITS SAUDI CONTACTS ARE LESS ENTHUSIASTIC ON QUESTION OF RECAPITALIZATION. (KAISSOUNI, IN ABOVE-CITED CONVERSATION WITH AMBASSADOR, SAID HE HAS HEARD FIGURE OF \$1,000 MILLION AS TOTAL GODE OFFICIALS HAVE IN MIND FOR REST OF 1978.) ALL GULF STATES, INCLUDING SAUDIS, HAVE RECENTLY BEEN CITING THEIR OWN LIQUIDITY PROBLEMS AS RATIONALE FOR CURBING AID OUTFLOWS. IT IS THEREFORE POSSIBLE THAT 1978 REPLENISHMENT MAY INITIALLY BE RELATIVELY SMALL INPUT MAINLY TO MAINTAIN CONTINUITY IN GODE FRAMEWORK, RATHER THAN CLEAR AND PRESENT REAFFIRMATION OF COMMITMENT TO EGYPT. FURTHER, STRONG POSITION TAKEN BY GODE ON ISSUE OF DISPOSITION OF SECOND TRANCHE FUNDS REFLECTS PERSISTENT CONTROVERSY OVER GODE'S OSTENSIBLE PURPOSE, I.E., WHETHER PROJECT ASSISTANCE OR BALANCE OF

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PAYMENTS SUPPORT TAKES PRIORITY. GOE STILL HOLDS PRINCIPAL GOAL SHOULD BE BALANCE OF PAYMENTS SUPPORT, WHILE

DONOR STATES ARE MORE INTERESTED IN PROJECT AID THAT WOULD LEAVE DEMONSTRABLE PROOF OF THEIR ASSISTANCE.

9. FINAL TRANCHE OF LARGE 1977 LOAN SHOULD BE FULLY UTILIZED WELL BEFORE END OF FIRST QUARTER, IN OPINION MOST FINANCIAL OBSERVERS. (KAISSOUNI TOLD AMBASSADOR RESIDUAL TOTAL IS DOWN TO \$300 MILLION.) GOE HAS SOME RESERVES IN PARALLEL ACCOUNTS, BUT IT IS UNCLEAR AS TO HOW MUCH REMAINS. ALTHOUGH EVIDENT THAT NET 1978 FOREIGN EXCHANGE REQUIREMENTS WILL BE WELL BELOW THOSE OF LAST YEAR, A COMPLETE ABSENCE OF GODE CASH COULD FORCE GOE BACK TO SHORT-TERM COMMERCIAL MARKETS BY MID-YEAR. THIS IS NOT PRESENTLY IN VIEW, BUT INEVITABLE FUTURE CONSEQUENCE OF DEPENDENCE ON BANKING FACILITIES IN LIEU OF CONCESSIONAL FOREIGN EXCHANGE ASSISTANCE WOULD BE, IN TIME, LIQUIDITY CRISIS OF MAGNITUDE EXPERIENCED IN PAST.

10. GODE INTENTIONS, OF COURSE, REMAIN CRITICAL AND UNKNOWN FACTOR IN THIS EQUATION. WE CANNOT AT THIS STAGE PREDICT HOW POLITICAL CONSEQUENCES OF SADAT'S INITIATIVE ON PEACE FRONT, PLUS POSSIBLE DOMESTIC OVERCONFIDENCE ON FISCAL GROUNDS OR UNFORESEEN REQUIREMENTS, WILL ALSO IMPINGE ON RECAPITALIZATION QUESTION. BEST-CASE SCENARIO WOULD BE \$2 BILLION REPLENISHMENT BEFORE PARIS CONSULTATIVE GROUP MEETING IN JUNE AND FIRM PLAN FOR FUTURE GODE ACTIVITIES WITH REGULARLY SCHEDULED RECAPITALIZATION. THIS WOULD BUY EGYPT CONSIDERABLE TIME ON FINANCIAL FRONT AND ENABLE SADAT TO CONTINUE CONCENTRATION ON PEACE EFFORTS. WHETHER THIS WILL BE POSSIBLE TO ARRANGE REMAINS TO BE SEEN. EILTS

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